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DOW THEORY LETTERS

"THE MARKET AS INTERPRETED UNDER THE DOW THEORY"

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CORRECT DOW THEORY. From 1900 to 1929 the public had access to great Dow Theory writing. Charles Dow wrote his Wall Street Journal editorials from 1897 to 1902, and William Hamilton, Dow's understudy and also editor of the Journal, carried on from 1903 to 1929. Hamilton's famous and prophetic piece, "The Turn of the Tide" graced the front page of the Wall Street Journal, Oct. 25, 1929. He called a definite bear market, but as history shows, Hamilton was largely ignored. From 1932 to 1939 Robert Rhea wrote a superb market letter as well as occasional pieces in Barron's. Since then there has been a scarcity of good Dow Theory writing. The teachings of Dow, Hamilton, and Rhea, for the most part, have since been bastardized and distorted by a variety of superficial dabblers. The public has had little access to the real principles and techniques that made the Theory famous. Many present day Dow Theorists have, through lack of study, reduced the Theory to a shallow charting of the averages. The mechanics of Dow Theory consist of recording the averages and calling bull or bear trends by watching successive highs or lows. The art of Dow Theory is in interpreting the movements of the averages through phases, duration, extent, rapidity, timing, volume, and all in relation to values.

AN UNPRECEDENTED BULL MARKET. Last week I sent readers a most bullish letter. The question everyone asks now is, "how long before a reaction?" I do not like to go too much by precedent in this unique bull market. It has already upset precedent in duration (almost 10 years), extent (368 points), deceptive reactions (last year), short positions (largest in history), and extent and duration of individual primary moves (the 1953-56 swing of 265.56 points). The present move has surpassed every move in history but the one just mentioned.

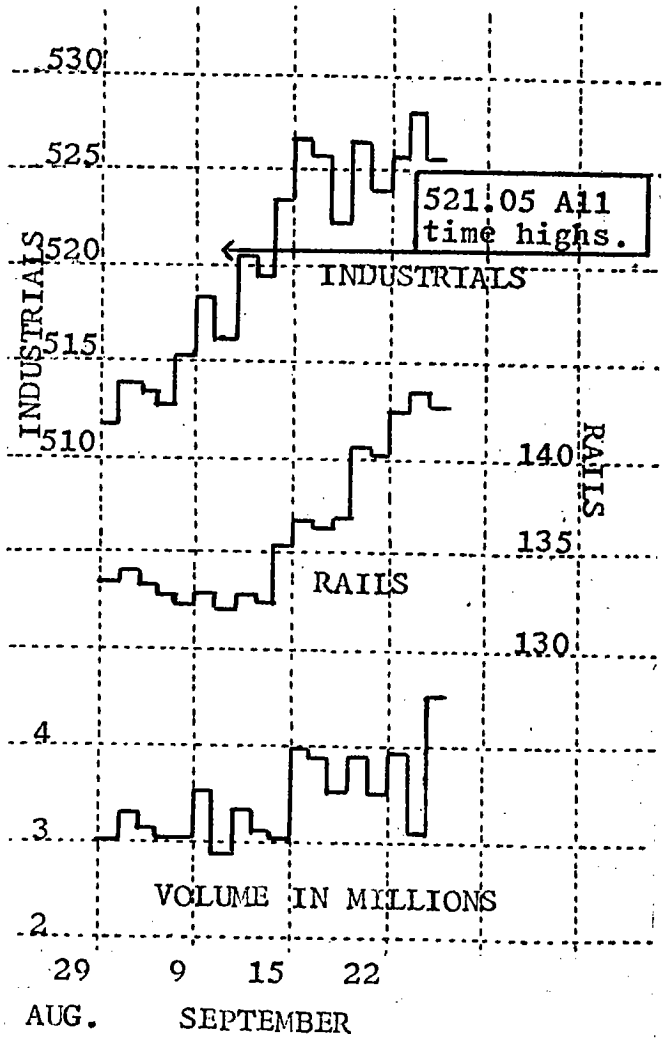
EXTENT AND DURATION. Dow and Hamilton insisted that the duration and extent of a move could not be determined in advance. Dow Theorists, unlike those market pundits whose pictures adorn magazine columns, must be content with attempting to forecast direction. Old-time observers, I believe, would be more than happy to be sure of direction most of the time. There are, however, certain technical tools which may aid us in guessing duration and extent. For instance, the refusal of the sensational short position to cover shows a stubborness on the part of the bears in recognizing what the averages have been shouting since last year, that this is still a bull market. The odd-lot (under 100 shares) selling continues to the present, presenting a picture of a skeptical and puzzled crowd taking profits before what they must feel is a great sell-off. Has not the advance lasted a year and climbed 109 points? War clouds, margins, tighter money, low yields, all these factors seem to be saying halt to a market that is causing many bearish analysts to lose their nightly sleep. But the more persistent the pessimism, the longer the advance is likely to continue. The length of the accumulation period is also of help in gauging the size of a coming move. This market has been consolidating since 1955, through shake-out after shake-out. Sputnik added the finishing touches to an unparalleled three year scare period in which the crowd was literally taken out of the market. Past experience tells us that the longer the consolidation period, the greater the ensuing move.

WHAT MAKES A REACTION. Dow Theorists know that stocks advance when investors, each acting on what he knows of his own business and the general economy,

feel that corporate earnings are headed higher. We also know that every move of the averages in either direction tends to overrun itself. Sooner or later the prosperity which the averages now see will be an obvious reality, even to the shorts. Then we bulls will gather friends as the bears and the under-invested climb aboard. As soon as we have too much company the market will become over-bought and technically weak. This will give birth to our first reaction. I will write more of this in our next letter.

DOW THEORY PRICE MOVEMENTS. A few weeks ago it was necessary for me to write a piece on the laggard rails and whether they were still a valid indicator of transportation in this country. I also said that I thought the rails were being accumulated by informed sources. Since breaking their "line" of accumulation, the rail average has advanced about 6%! Industrials (see chart) have bullishly climbed up, seeming to consolidate each move with a little decline. Note that each decline has ended above the previous bottom. This steady "up two--down one" movement serves to keep the crowd fearful and the market strong as it moves forward. Since the 521.05 breakthrough the great primary trend has once again come in force, and the two averages moving "in gear" have made a most bullish pattern. In the past when a great war was imminent the averages were able to see the danger far in advance. They would either form a very long line of distribution or decline to a point where they discounted the worst that they could see ahead. Based on their present performance, as of this writing, the far-seeing averages do not seem to admit that a war is in the cards.

STOCKS. As stock prices head up, it becomes more and more difficult to pick values. It seems to this observer that the following are behind the market. OILS. The group in general is still suffering from bad news. SINCLAIR, STANDARD OF INDIANA, CALIFORNIA, PURE. The steels have made a good move in general. I would rather buy other metals. KAISER ALUMINUM, AMERICAN SMELTING, ANACONDA, OR CHEAPER COPPERS. I like the science stocks like THOMPSON PRODUCTS, NORTH AMER. AVIATION, WESTINGHOUSE (way behind in my opinion) GENERAL ELECTRIC, and SYLVANIA.



CHEAP STOCKS like ADMIRAL, AMER. CABLE, HUPP, AVCO, SPARTON, HOTEL CORP., BALDWIN LIMA HAMILTON, CONTINENTAL MOTORS, ASHLAND OIL, and FELMONT OIL (on the Amer. Exchange). We have to go on the premise that in a boom all stocks make their move and those that are behind have a lot of catching up to do.

I note that "tips" are beginning to fly like winter snow. This is typical of the sort of public interest we can expect in the third or "boom" phase of the market. The best tip that this writer knows is--avoid tips!

BROCHURE. Enclosed are two copies of our new brochure. It was written for the benefit of new subscribers and prospective customers, although I hope it may prove of use to older readers. I would appreciate it if readers could give the extra copy to any friend who might be interested in the Dow Theory of the market. More copies will be sent on request. Thank you.